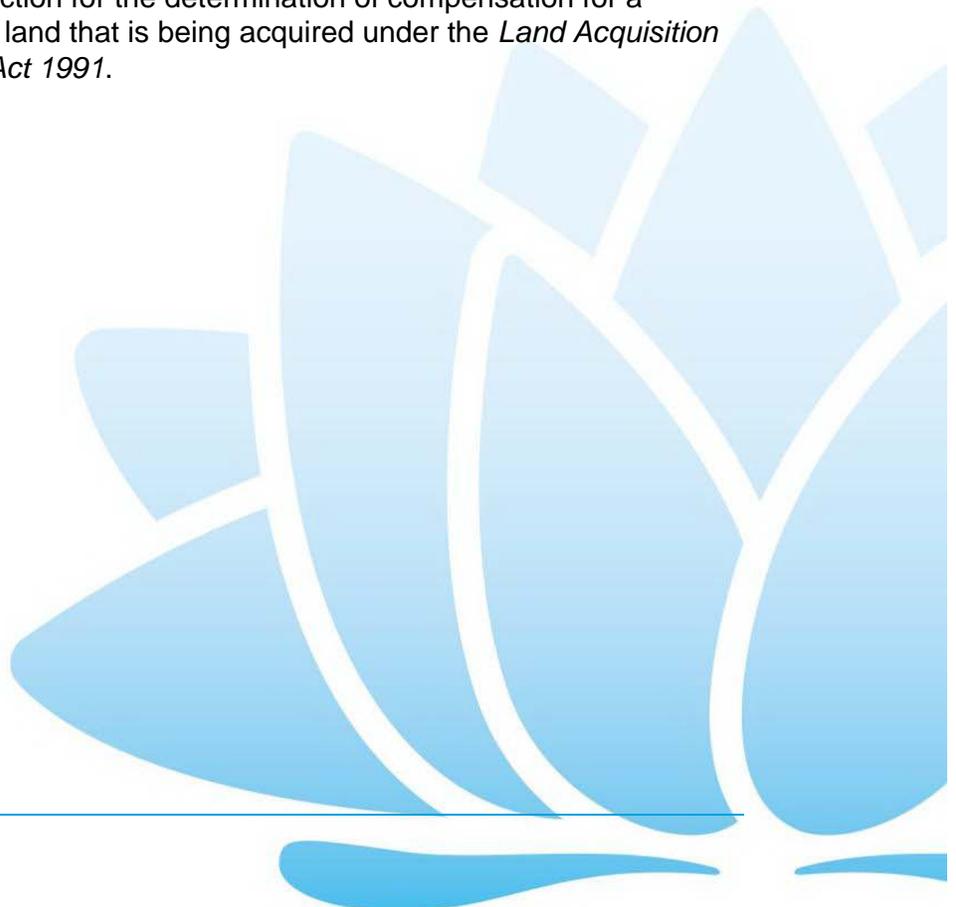




Determination of compensation following the acquisition of a business

These guidelines provide direction for the determination of compensation for a business being conducted on land that is being acquired under the *Land Acquisition (Just Terms Compensation) Act 1991*.



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1 Context

1.1 Role of guidelines

These guidelines provide direction to all NSW acquiring authorities in determining compensation for a business conducted on land that is acquired in accordance with the *Land Acquisition (Just Terms Compensation) Act 1991* (the Act).

The policy objectives of these guidelines are:

- fairness in the determination of compensation for a business
- consistency in the determination of compensation for a business
- transparency in the process for determining compensation for a business
- evidence-based decisions with a clear rationale for determining compensation for a business

2 Guidelines

2.1 Scope

Compensation for business on land that has been compulsorily acquired

These guidelines apply to all acquiring authorities in New South Wales, as defined in the Act.

This document is a guide as to how acquiring authorities will assess compensation payable where there was a business being conducted on the acquired land. Each case should be considered on its individual merits.

The acquired land can be either the whole of the property or part of the property. The business interest may be in the same ownership as the “land” or may be a non-related party.

2.2 Who is entitled to compensation?

Where a business was being conducted on the land, it is first necessary to consider the legal status of the business.

Sole trader

If the business was being conducted by its owner as a sole trader, the business is not a separate legal entity. The business itself does not own an interest in the land in that situation. Therefore the claim for compensation associated with the sole trading business must be made by the individual(s) who own and operate the business in their personal capacity. This is most commonly done by sole traders as part of their claim as the owner of the land or as a lessee.

Corporation

Where the business was being conducted by a corporation and the corporation has an interest in the land (again usually by way of owning the land or having a lease from the owner), that entity must lodge the claim for compensation. If the corporation owns the land and also operates its business on that same land then there would be only one claim for compensation. If there are different corporations that own the land and operate the business separate claims are required.

Sometimes companies operate businesses on land via a verbal agreement lease or licence. Depending on the circumstances, the company may still have an interest in land entitling it to compensation. This may include documentation that clearly demonstrates the payment of rent over a long

period of time.

Business must be lawful

To be entitled to compensation, the business must be lawful. Compensation is not payable for relocation costs associated with an illegal enterprise.

Where a business is operating without development consent and consent could be provided by the local council if an application was made, the business owner would still be eligible for compensation. The compensation however needs to have regard to the fact that the business does not currently have the approval which would involve time, cost and risk.

2.3 Market value and disturbance

Market value

A business is not entitled to compensation for market value unless there is a *profit rental* in existence. A profit rental is where the current rent being paid is less than the market rent. A profit rental has a value to the owner that must be compensated. In these situations the rental saving is calculated for the term of the saving, normally the un-expired lease term or until the next market rental review. The amount is calculated as the lump sum, present value of the saving for the remaining period of the lease or the next market rental review.

Disturbance items

References to “persons” in the Act include businesses where appropriate. Claims by a business are usually made as a claim for disturbance. Depending on the circumstances of each individual case, the typical categories of disturbance that may be claimed by a business under Section 59(1) of the Act are:

- (a) **legal costs** reasonably incurred by the persons entitled to compensation in connection with the compulsory acquisition of the land
- (b) **valuation fees** of a qualified valuer reasonably incurred by those persons in connection with the compulsory acquisition of the land (but not fees calculated by reference to the value, as assessed by the valuer, of the land)
- (c) financial costs reasonably incurred in connection with the **relocation** of those persons (including legal costs but not including stamp duty or mortgage costs)
- (d) **stamp duty costs** reasonably incurred (or that might reasonably be incurred) by those persons in connection with the purchase of land for relocation (but not exceeding the amount that would be incurred for the purchase of land of equivalent value to the land compulsorily acquired),
- (e)
- (f) **any other financial costs** reasonably incurred (or that might reasonably be incurred), relating to the actual use of the land, as a direct and natural consequence of the acquisition.

Valuation considerations

Compensation must be calculated on the basis of either relocation or extinguishment of the business. The business's actual intention for the future is not necessarily relevant when establishing whether to assess the compensation based on relocation or extinguishment.

Relocation cost is covered in section 59(c) of the Act.

Extinguishment is covered in section 59(f) of the Act as *any other financial costs*, and in simple terms represents the value of the business as a going concern if sold or purchased.

The most appropriate method given the circumstances should be adopted. For example, a café in a high street location with vacant shops of a similar standard could easily relocate.

However a unique waterfront restaurant in a rare location would have difficulty re-establishing in the same area.

The difference between the two approaches shouldn't favour exorbitant outcomes, but neither should it be miserly. Five questions need to be considered:

- a. Can the business be relocated?
- b. Does the proprietor intend to relocate?
- c. In the circumstances, would a reasonable person relocate?
- d. Is it feasible and practicable to relocate within a reasonable timeframe?
- e. Will the relocation cost be less than the cost of extinguishment?

The assessment of compensation for business disturbance must be made whether the costs associated have actually been incurred or not. Costs that have not occurred at the date of acquisition but which might reasonably be incurred are still to be considered.

However it must be reasonable that they would be incurred. The term 'incurred' is to be given the broadest interpretation possible, as it relates to costs that might reasonably be expected to be incurred given the balance of probability.

Care should be taken to ensure that costs are not exorbitant.

Exorbitant costs would not be "reasonably incurred". In other words, there is an element of *reasonableness* in the test concerning the quantum of claimable costs. Business owners are obliged to take appropriate steps to mitigate loss.

Professional fees for legal, valuation and other services must relate directly to the acquisition. No amounts are assessed for possible future court action which may or may not eventuate. If court action were to occur the business will have a further opportunity to have costs considered.

Compensation for a business is limited to direct financial costs reasonably incurred or that might reasonably be incurred as a result of the acquisition. Secondary impacts due to the nature of the works constructed on the acquired land may only be considered as part of a claim that includes the market value of the land.

For example, if the design of the works limits access to a site, that may be a loss to the market value of the land, however, it is not a direct financial cost which is compensable for the business.

Relocation

The types of costs that can be claimed are broad. Each situation will be different and must be considered on its merits.

Typical relocation costs claimable under section 59(1)(c) by the owner of a business interest may include, but are not limited to -

- Legal Costs
- Valuation Fees
- Professional costs relating to securing a replacement location
- Fit-out costs for the replacement location
- New signage
- Costs of reprinting stationary
- Notification of new address to customers
- Costs of relocating telephones and internet services
- Costs of removing computers
- General removal expenses
- Stock losses (not the value of the stock on hand)
- Australia Post mail redirection
- Loss of business profits due to acquisition.

An important principle of business compensation is that the costs of re-establishing improvements that existed on the acquired land, cannot be claimed if they were included in the assessment of market value. To do so would be compensating for the same item twice. For example, if the claimant was paid for the value of a loading dock, then the costs of installing a loading dock on the new premises would not be claimable.

Future lost profits

Future lost profits for the reasonable time it takes to relocate and re-establish a business enterprise can be considered as a disturbance item.

No compensation is to be determined for future lost profits due to the unrealised potential of land. Such potential is contained within the market value.

Paying a higher rent at new location

The underlying principal of just compensation is to ensure the disposed owner is not placed in a better or worse position as a result of the acquisition. There may be occasions when a business interest relocates but is required to pay more rent in the new location. Compensation is to include the extra rental required, as long as there is no additional income or saving benefits to the business and it should be calculated for the remaining period of the lease that the business had before the acquisition.

2.4 Valuation approach

Extinguishment	<p>Extinguishment represents the market value of the business if sold as a going concern. The most appropriate method to value a business as a going concern is by the capitalisation of future maintainable earnings.</p> <p>No compensation is to be determined for lost future profits as this is accounted for in the value of the business as a going concern.</p> <p>No compensation is to be determined for lost future profits due to the unrealised potential of land. Such potential is also contained within market value.</p>
Types of extinguishment costs	<p>The types of costs claimable for the extinguishment of a business interest under section 59(1)(f) include, but are not limited to:</p> <ul style="list-style-type: none">▪ Legal Costs▪ Valuation Fees▪ Value of the business as a going concern▪ Stock losses if not included in the value of the business (and not the value of the stock on hand)▪ Administrative and possible penalty costs of winding up the business.
Tax	<p>Where compensation is paid for relocation it should be goods and services tax (GST) inclusive. That is the full costs actually, or likely, to be incurred, irrespective of a claimant's specific circumstances in relation to GST.</p> <p>Compensation is payable for GST on professional fees for legal, valuation and other services that relate directly to the acquisition.</p> <p>Where compensation is based on the extinguishment of a business interest, it will reflect the value of the business as a going concern and, consequently, there is no liability for GST.</p> <p>Compensation is not to be adjusted for company tax or capital gains tax liabilities.</p>

2.5 Where businesses own the acquired land

Where the land and business interest are the same entity and compensation for the land has been based on a higher use than the current use, there may be no compensation to be determined for the business interest.

For example, the existing use value of the land is \$2 million and the business value is \$1 million, giving a total value of \$3million. By comparison, the value of the land for redevelopment may be \$5 million. In this example compensation would be assessed at a total of \$5 million and no business compensation given.

2.6 Definitions

“Sole trader”

A sole trader is a business entity where one individual trades, controls and manages the business. They are legally responsible for all aspects of the business, and debts and losses can't be shared with other individuals.

“Corporations”

A corporation is a business entity that legally exists separately from its owner(s). The owners of a corporation are shareholders; their percentage of ownership in the business is represented by their corporate stocks or shares. Shareholders can choose a board of directors to manage business operations, or they can create a shareholders' agreement, which will allow them to manage the business directly.

“Business compensation”

The Act does not specifically refer to business compensation but section 4 defines “land” as any interest in the land, this includes:

- a legal or equitable estate or interest in the land, or
- an easement, right, charge, power or privilege over, or in connection with, the land.

This means that a business is considered to be an interest in land that is entitled to be compensated if it is “acquired”.

3 References

3.1 Laws and guidelines

Governing law *Land Acquisition (Just Terms Compensation) Act 1991*

Central Policy Office, Office of the Secretary

Address: McKell Building, 2-24 Rawson Place, Sydney NSW 2000

Phone: 02 9372 8877 | TTY: 1300 301 181

